



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
Attn: Mandatory Review, MC 4920 DAL  
1100 Commerce St.  
Dallas, TX 75242

501.19-00

Date: December 17, 2009

Release Number: **201013054**

Release Date: 4/2/10

ORG

ADDRESS

Employer Identification Number:  
Person to Contact/ID Number:  
Contact Numbers:

Dear

In a determination letter dated November 19XX, you were held to be exempt from Federal income tax under section 501(c)(19) of the Internal Revenue Code (the Code).

Based on recent information received, we have determined you have not operated in accordance with the provisions of section 501(c)(19) of the Code. Accordingly, your exemption from Federal income tax is revoked effective January 1, 20XX. This is a final adverse determination letter with regard to your status under section 501(c)(19) of the Code.

We previously provided you a report of examination explaining why we believe revocation of your exempt status is necessary. At that time, we informed you of your right to contact the Taxpayer Advocate, as well as your appeal rights. On January 7, 20XX you signed Form 6018-A, *Consent to Proposed Action*, agreeing to the revocation of your exempt status under section 501(c)(19) of the Code.

You are therefore required to file Form 1120 U. S. Corporation Income Tax returns, for the years ended December 31, 20XX and December 31, 20XX with the Ogden Service Center. For future periods, you are required to file Form 1120 with the appropriate service center indicated in the instructions for the return.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a

petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Nanette M. Downing  
Acting Director, EO Examinations



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
TE/GE EO Examinations  
1122 Town and Country Commons Room 128  
Chesterfield, MO 63017-8293

September 25, 2009

ORG  
ADDRESS

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

Letter 3610 (04-2002)  
Catalog Number 34801V

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

If you accept our findings, please sign and return the enclosed Form 6018, *Consent to Proposed Adverse Action*. We will then send you a final letter modifying or revoking exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Sunita B. Lough  
Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Form 6018  
Report of Examination  
Envelope

**EXHIBIT A**

REVENUE-			REVENUE-	
Month	Deposit Amount		Month	Deposit Amount
January			January	
February			February	
March			March	
April			April	
May			May	
June			June	
July			July	
August			August	
September			September	
October			October	
November			November	
December			December	
<b>TOTAL</b>			<b>TOTAL</b>	
Utilities			Utilities	
Food			Food	
Liquor			Liquor	
<b>TOTAL</b>			<b>TOTAL</b>	

**Loss amount** **\$0.00** **Loss amount** **\$0.00**

Losses are made up by officers from the revenue of their farm and the secretary's income from job per interview. Interview appears credible.

ORG  
F990, 20XX12 and 20XX12  
PRESIDENT

Exhibit C

ORG For The 20XX Calender Year

<u>Name</u>	<u>Type of member</u>
MEMBER	Veteran
MEMBER	Veteran Status Not Verified
MEMBER	Veteran
MEMBER	Veteran Status Not Verified
MEMBER	Veteran
MEMBER	Veteran
MEMBER	Relative of Veteran
MEMBER	Relative of Veteran
MEMBER	Relative of Veteran
MEMBER	Relative of Veteran
MEMBER	Relative of Veteran
MEMBER	Relative of Veteran
MEMBER	Relative of Veteran
MEMBER	Relative of Veteran
MEMBER	Relative of Veteran
MEMBER	Relative of Veteran
MEMBER	Relative of Veteran

Total Veteran Members	12
Total Relatives of Veterans	11
Veteran Status Not Verified	2
Total Members	<u>25</u>

% of Veteran Members to Total Members 48%

Form <b>886A</b>	Department of the Treasury - Internal Revenue Service <b>Explanation of Items</b> <b>Draft Proposed Revocation</b>	Schedule No. or Exhibit: Form 6018-A
<b>Name of Taxpayer</b> ORG ADDRESS City, State		<b>Year/Period Ended</b> 12/31/20XX 12/31/20XX

LEGEND

ORG = Organization name      Address = address      XX = Date      City = City  
State = state      CO\_1 = 1<sup>st</sup> company      President = president      DIR-1 & DIR-2  
1<sup>st</sup> & 2<sup>nd</sup> Director

**Issues:**

1. Whether ORG is operated exclusively for purposes listed in Treas. Reg. § 1.501(c)(19)-1(c).
2. Whether ORG has satisfied the recordkeeping and reporting requirements set forth in I.R.C. §§ 6001 and 6003.
3. Whether ORG’s exemption under I.R.C. § 501(a), as an organization described in I.R.C. § 501(c)(19), should be revoked effective January 1, 20XX.
4. Alternatively, if ORG’s exemption under I.R.C. § 501(a), as an organization described in I.R.C. § 501(c)(19), is not revoked, whether the income that ORG received from its bar operations, vending machines, Keno and gaming activities should be treated as unrelated business income under I.R.C. § 512, and whether such income is subject to tax pursuant to I.R.C. § 511.

**Facts: Background Information**

ORG Headquarters (hereinafter referred to as ORG HQ) is a veterans organization that holds a group exemption for veterans organizations described in I.R.C. § 501(c)(19). ORG HQ’s web page states that its mission is to

ORG HQ’s website lists several advantages to be included in its group exemption as a subordinate organization. These advantages include selling liquor, operating on Sundays, holding bingo games, and obtaining liquor licenses in dry counties. ORG HQ’s website offers its group exemption to existing bars and restaurants located in State. ORG HQ’s website states that ORG HQ will assist in a club’s formation and application for a liquor license. ORG HQ refers to its subordinate organizations as “clubs.”

ORG HQ’s website requires that its clubs have at least      veteran members. ORG HQ also requires its subordinate organization to send it proof of all veterans affiliation. One question that appears on ORG HQ’s web page is      The response is

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### **ORG's Formation and Purpose**

The organization's Articles of Incorporation, dated April 23, 20XX, shows that the organization was formed to support all veterans and their families. The ORG opened the club in April 20XX under the ORG HQ. Prior to 20XX, the organization was operated for a short time as a CO-1 State. When this business was sold, someone from State Alcohol and Tobacco told them about the ORG organization.

The organization does not have its own bylaws. ORG provided the Constitution & Bylaws of the ORG HQ, which is what the subordinate organization uses. These bylaws have as their stated purposes "the uniting fraternally of veterans and the families of veterans in order to better the lives of all veterans and their families and to assist with any difficulties encountered by them." These purposes include but are not limited to the following:

- A. Help fellow veterans and their families receive the benefits for which they are entitled;
- B. Find employment for veterans and their families;
- C. Help the homeless veterans find housing and re-adjust to civilian life;
- D. Carry on programs to perpetuate the memory of deceased veterans and members of the armed forces, and to comfort their survivors;
- E. Sponsor or participate in activities of a patriotic nature;
- F. Provide social and recreational activities for its members;
- G. Assist the disabled and needy war veterans and their dependents;
- H. Promote awareness of the prisoners of war and the missing in action issues;
- I. Promote the general welfare and prosperity of all ORG corporations;
- J. Present and support the purposes of ORG before the public and the government.

### **ORG's Business Operations, Business Activities, and Members**

The examination was for periods ending December 31, 20XX and December 31, 20XX. The ORG operates its business on a cash basis. The records indicate that the organization took cash only, at Address, City, State. The building's facade exhibits signs stating "ORG". The facility consists of approximately 1000 sq. ft. of space. There is a full service bar, a pool table, lottery, and a juke box. The organization's founder and President, is a \_\_\_\_\_ The organization's board of directors consisted of DIR-1., and DIR-2, wife of President.

The ORG's facilities are open 6 days a week. Its hours are Monday through Saturday 3:00 PM to 7:00 PM. It is open to both members and nonmembers (general public). The ORG averages approximately

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seven people per day. ORG sent proof of the veteran status of its members to ORG HQ. The ORG, as of December 20XX, had a total of 26 members. Of those 26 members, 12 were veterans, 13 were relatives of veterans, and one had not had their veteran status verified. The ORG, as of December 20XX, had a total of 25 members. Of those 25 members, 12 were veterans, 11 were relatives of veterans, and two had not had their veteran status verified. See Exhibits B and C for further details.

The organization pays for the members dues annually to the ORG HQ, and, therefore, the members are not vested in the organization. ORG paid the ORG HQ dues for 20XX in the amount of \$ on check #. Also, ORG paid the ORG HQ dues for 20XX in the amount of \$ on check #.

ORG does not have a sign-in book for member or nonmembers to sign when they use the organization's facilities. ORG charges its members and nonmembers the same price for liquor. ORG accounted for member and nonmember bar/kitchen sales separately. According to the organization's records, 3.06% of the bar receipts were from nonmembers in 20XX and 0.7% of the bar receipts were from non members in 20XX. The amount of nonmember income for 20XX was \$ and for 20XX was \$.

ORG had records to support the amount of social activities for members such as: fish fries, barbecues, Holiday dinners, and Christmas and Easter baskets. The organization also had records to support the solicitation of donations or gifts from members and nonmembers for veterans.

### **ORG's Financial Information**

The ORG's deposits for 20XX were \$ and the gross sales<sup>1</sup> were \$. The deposits for 20XX were \$\$ and the gross sales were \$. The organization makes up the difference with income from DIR's farm and from selling their goats.

The ORG borrowed \$ in 20XX to make repairs on the roof of the organization. Of the \$ borrowed, \$ has been verified as having gone toward roof repairs. The balance was deposited into the organization's checking account to be used for general expenses.

The ORG purchased goats in 20XX for \$ and in 20XX for \$ for the DIR's farm. The organization is using the same checking account for personal business as well as for the organization.

### **ORG's Activities, Revenues, and Expenses**

The following is a list of the organization's activities for 20XX and 20XX:

\* \* \* \*

<sup>1</sup> For purposes of this discussion, the term "gross sales" means "gross receipts" as reported on the organization's Form 990.

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20XX ACTIVITIES					
ACTIVITY	EXEMPT	NON-EXEMPT	HOURS	REVENUE	EXPENSES
Provide Easter baskets to children	X		4	Club members bought items	None
Memorial Day BBQ in honor of local veterans	X		9	0	
Put flags on veterans graves during Memorial Day	X		4	0	
July 4th cookout for members	X		9	0	
August float trip & BBQ for members	X		9	0	
Labor Day fish fry	X		4	0	
Halloween Parade with flags displayed	X		2	0	
Provide Christmas gifts for children in community & food baskets for needy veterans	X		4	0	
New Year's Eve party for members	X		4	0	
Operate bar that non-members patron		X			
Operate bar that members patron	X		4	0	
Note: Estimates from President & Secretary-Treasurer.					

20XX ACTIVITIES					
ACTIVITY	EXEMPT	NON-EXEMPT	HOURS	REVENUE	EXPENSES
Halloween Parade	X		2	0	
July 4th BBQ-member event	X		9	0	
Memorial Day BBQ member	X		9	0	
Veterans Day fish fry	X		4	0	
St. Patrick's Day corn beef, cabbage member event	X		14	0	
Around St. Patrick's-crawfish bowl-member event	X		6	0	
Quarterly member meetings	X		4	0	
Operate bar that non-members patron		X			
Operate bar that members patron	X		4	0	
Note: Estimates from President & Secretary-Treasurer.					

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In reviewing the activities, the organization is performing more exempt than non-exempt activities.

ORG did not have a sign-in book at the door; however, the organization did keep manual records for the non-member income vs. member income. The President would keep track on the cash register for member income and non member income. DIR-1 would add up the receipts and track this manually on spreadsheets. For 20XX, the member income was \$ and non-member income was \$. For 20XX, the member income was \$ and non-member income was \$. The organization's records demonstrate that the majority of the organization's income is from the members.

Per the 20XX return, the gross sales of the organization were \$. Explained to the accountant that when a return is filed, the return needs to be filled out completely. The organization's gross receipts per the audit were \$ for the year 20XX. The member income of \$ plus the non-member income of \$ plus \$ from the State lottery income and income from the pool table and juke box equals \$. The organization's expenses for liquor, rent, utilities, and other services for 20XX were \$. See Exhibit A for additional details.

Per the 20XX return, the gross sales of the organization were \$. The organization's gross receipts per the audit were \$ for the year 20XX. The member income of \$ plus the non-member income of \$ plus the State lottery income and income from pool table and juke box of \$.16 equals \$. The organization's expenses for liquor, rent, utilities, and other services for 20XX were \$. See Exhibit A for additional details.

### LAW AND ANALYSIS

#### **Tax Exemption - Veterans Organizations**

Prior to the enactment of I.R.C. § 501(c)(19) by Public Law 92-418, 1972-2 C.B. 675, many veterans organizations qualified for exemption from federal income tax under I.R.C. § 501(c)(4) because most of the traditional activities of these organizations were recognized by the IRS as primarily promoting social welfare. Staff of Joint Comm. on Taxation, 109<sup>th</sup> Cong., Historical Development and Present Law of the Federal Tax Exemption for Charities and Other Tax-Exempt Organizations, JCX-29-05 NO 8, (Comm. Print 2005). The traditional activities of veterans organizations that were social welfare organizations included promoting patriotism, preserving the memory of those who died in war, and assisting veterans in need. Id. A veterans organization whose primary activity consisted of operating social facilities for its members was not able to qualify for exemption as a § 501(c)(4) social welfare organization, but it could qualify as a social club under § 501(c)(7). Rev. Rul. 66-150, 1966-1 C.B. 147; S. Rep. No. 1082, 92d Cong., 2d Sess. 2 (1972) reprinted in 1972-2 C.B. 713; H.R. Rep. No. 851, 92d Cong., 2d Sess. 1 (1972).

In 1972, Congress enacted I.R.C. § 501(c)(19) and I.R.C. § 512(a)(4) to address the concern that a veterans organization exempt under I.R.C. § 501(c)(4) or (7) may be subject to unrelated business income tax on the provision of insurance to its members. S. Rep. No. 1082, 92d Cong., 2d Sess. 2

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(1972) reprinted in 1972-2 C.B. 713.<sup>2</sup> Section 512(a)(4) excludes amounts attributable to, or set aside by a §501(c)(19) veterans organization for the payment of life, sick, accident, or health insurance benefits for their members and their members' dependents. Public Law 92-418, 1972-2 C.B. 675.

## The Section 501(c)(19) Exemption Requirements

### In General

Section 501(c)(19) of the Internal Revenue Code provides for the exemption from federal income tax of a post or organization of past or present members of the United States Armed Forces if it is:

- a) organized in the United States or any of its possessions,
- b) at least 75 percent of the members of which are past or present members of the Armed Forces of the United States
- c) substantially all of the other members of which are individuals who are cadets or are spouses, widows, widowers, ancestors, or lineal descendants of past or present members of the Armed Forces of the United States or of cadets, and
- d) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

### Membership Requirements

Under I.R.C. § 501(c)(19), at least 75 percent of an organization's members must be past or present members of the Armed Forces of the United States ("veterans"). Section 501(c)(19) does not define the term "Armed Forces of the United States." The regulations under I.R.C. § 501(c)(19), likewise, do not define the term. Section 7701(a)(15) of the Code, however, defines "Armed Forces" to include all regular and reserve components of the uniformed services which are subject to the jurisdiction of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force, and the Coast Guard.

In addition, I.R.C. § 501(c)(19)(B) requires that substantially all other members of an organization be cadets or spouses, widows, widowers, ancestors, or lineal descendants of veterans or cadets. According to the Senate Report accompanying the legislation, "substantially all" means 90 percent. See S. Rep. No. 1082, 92<sup>nd</sup> Cong. 2d Sess. 5 (1972), reprinted in 1972-2 C.B. 713, 715. Therefore, of the 25 percent of the members that do not have to be veterans, 90 percent must be cadets, or spouses, etc.

\* \* \* \*

<sup>2</sup> "Before the enactment of the Tax Reform Act of 1969, there was no tax on the insurance activities of the veterans' organizations since the unrelated business income did not apply to social welfare organizations and social clubs. However, the 1969 Act extended the application of the unrelated business income tax to virtually all exempt organizations including social welfare organizations and social clubs." S. Rep. No. 1082, 92d Cong., 2d Sess. 2 (1972) reprinted in 1972-2 C.B. 713.

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Consequently, no more than 2.5 percent (10% x 25%) of an I.R.C. § 501(c)(19) organization's total membership may consist of individuals not mentioned in the statute.<sup>3</sup>

Neither, I.R.C. § 501(c)(19), its legislative history, nor the regulations under I.R.C. § 501(c)(19) define what it means to be a member of a veterans organization. However, whatever the organization requires for one to become a member, the organization must maintain records tracking who its members are and the proportions in the various categories of membership permitted under I.R.C. § 501(c)(19)(B) (member of armed forces, cadet, relative, etc.) to substantiate that its members are veterans or other permitted members. See I.R.C. § 6001 and Treas. Reg. § 1.6001-1(c).<sup>4</sup>

### Operational Test

Section 1.501(c)(19)-1(c) of the Regulations provides that an organization exempt under §501(c)(19) must be operated exclusively for one or more of the following purposes:

- 1) To promote the social welfare of the community as defined in Section 1.501(c)(4)-1(a)(2),
- 2) To assist disabled and needy war veterans and members of the United States Armed Forces and their dependents and widows and orphans of deceased veterans,
- 3) To provide entertainment, care, and assistance to hospitalized veterans or members of the Armed Forces of the United States,
- 4) To carry on programs to perpetuate the memory of deceased veterans and members of the Armed Forces and to comfort their survivors,
- 5) To conduct programs for religious, charitable, scientific, literary, or educational purposes,
- 6) To sponsor or participate in activities of a patriotic nature,
- 7) To provide insurance benefits for their members or the dependents of their members or both, or
- 8) To provide social and recreational activities for their members.

\* \* \* \*

<sup>3</sup> Prior to 2003, ancestors and lineal descendent were not included in the statutory list of persons permitted to be members. In 2003, Congress amended I.R.C. § 501(c)(19) to include ancestors or lineal descendents of present or former members of the United States Armed Forces or cadets in the statutory list of individuals who may be members of an organization. The regulations have not been updated to reflect this change nor do they reflect the 1982 statutory change eliminating a requirement that veterans be veterans of war.

<sup>4</sup> Section 6001 of the Code provides that every person liable for any tax imposed by the Code, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time proscribe. Every organization exempt from tax under § 501(a) and subject to the unrelated business income tax, including veterans organizations, must keep such records. Treas. Reg. § 1.6001-1(a). These books and records are required to be available for inspection by the Service. Treas. Reg. § 1.6001-1(a). In addition, veterans organizations are required to keep books and records to substantiate information reported on their information return. See I.R.C. § 6033 and Treas. Reg. § 1.6001-1(c). They are also required to submit additional information to the Service for the purpose of enabling the Service to inquire further into its exempt status.

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Treas. Reg. § 1.501(c)(19).

### Social and Recreational Activities for Members

While Treas. Reg. § 1.501(c)(19)-1(c)(8) does not address what it means to “exclusively” provide social and recreational activities for members it is similar to the exempt purpose contained in I.R.C. § 501(c)(7), as both provisions permit an exempt organization to operate social and recreational facilities for its members. In fact, prior to the enactment of I.R.C. § 501(c)(19), a veterans organization whose primary activity consisted of operating a bar or restaurant for the benefit of its members would have to qualify as § 501(c)(7) social club to be tax-exempt. See Rev. Rul. 60-324 and Rev. Rul. 69-219.<sup>5</sup> These organizations, prior to 1976, were required to operate “exclusively” for the pleasure and recreation of its members. See I.R.C. § 501(c)(7) (1975). Thus, the rulings and case law under I.R.C. § 501(c)(7) are useful for purposes of determining whether an I.R.C. § 501(c)(19) veterans organization is providing social and recreational activities exclusively for its members.

Treas. Reg. § 1.501(c)(7)-1(b) provides that a club that engages in business, such as making its social and recreational facilities available to the general public is not organized and operated exclusively for pleasure, recreation, and other nonprofit purposes, and is not exempt under I.R.C. § 501(a). Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes.

In West Side Tennis Club v. Commissioner, 111 F.2d 6 (2<sup>nd</sup> Cir. 1940), cert. denied, 311 U.S. 674 (1940), the Second Circuit upheld the board of tax appeals determination that a social club was not exempt because a substantial amount of its income was received from the general public. West Side Tennis Club was organized to provide tennis facilities for the use and enjoyment of its members. The facilities were only available to members for most of the year; the club hosted annual national championship tennis matches, however, that were open to the general public. The club shared in the ticket proceeds from these matches. The Second Circuit upheld the board of tax appeals determination that the national championship matches were a substantial and profitable business which jeopardized the club’s exemption. West Side Tennis Club, 111 F.2d at p. 7.<sup>6</sup>

\* \* \* \*

<sup>5</sup> In 1976, Congress amended § 501(c)(7) replacing “exclusively” with “substantially all.” This change was effected to establish that social clubs will not jeopardize their exempt status if they receive 35% of their gross receipts from non-membership sources. Only 15% of their gross receipts, however, may be derived from nonmembers’ use of club facilities or services. Pub. L. No. 92-568, S. Rep. 1318, 94 Cong., 2d Sess. (1976).

<sup>6</sup> In 1976, Congress amended § 501(c)(7) replacing “exclusively” with “substantially all.” This change was effected to establish that social clubs will not jeopardize their exempt status if they receive 35% of their gross receipts from non-membership sources. Only 15% of their gross receipts, however, may be derived from nonmembers’ use of club facilities or services. Pub. L. No. 92-568, S. Rep. 1318, 94 Cong., 2d Sess. (1976).

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In Rev. Rul. 60-324, 1960-2 C.B. 173 and Rev. Rul. 69-219, 1969-1 C.B. 153, the Service held that a § 501(c)(7) social club is not operated exclusively for the pleasure or recreation of its members if it makes its facilities available to the general public to a substantial degree. Id. However, this does not mean that all dealings with the general public are necessarily inconsistent with the club's exempt purposes. For instance, in Rev. Rul. 60-324, 1960-2 C.B. 173, the Service stated that:

[w]hile [the] regulations indicate that a club may lose its exempt status if it makes its facilities available to the general public, [it] does not mean that any dealings with outsiders will automatically cause a club to lose its exemption. A club will not lose its exemption merely because it receives some income from the general public, that is, persons other than members and their bona fide guests, or because the general public may occasionally be permitted to participate in its affairs, provided such participation is incidental to and in furtherance of its general club purposes and the income therefrom does not inure to members.

In 1971, the Service issued Revenue Procedure 71-17, 1971-1 C.B. 683, which contains guidelines for determining the impact of an organization's nonmember gross receipts on its exempt status under I.R.C. § 501(c)(7). The revenue procedure provides that "[a] significant factor reflecting the existence of a nonexempt purpose is the amount of gross receipts derived from use of a club's facilities by the general public." The revenue procedure went on to provide a safe harbor for organizations serving the general public:

As an audit standard, [the gross receipts derived from the general public] alone will not be relied upon by the Service if annual gross receipts from the general public for [use of the club's facility] is \$ or less or, if more than \$ where gross receipts from the general public for use is five percent or less of total gross receipts of the organization.

Rev. Proc. 71-17, 1971-1 C.B. 683 at § 3.01.

The term "general public" is defined as persons other than members or their dependents or guests. Id. at § 2.01. Section 3.03 of Rev. Proc. 71-17 provides four instances in which nonmembers are assumed to be the guests of the members. The assumptions include:

Where a group of eight or fewer individuals, at least one of whom is a member, uses club facilities, it will be assumed for audit purposes that the nonmembers are the guests of the member, provided payment for such use is received by the club directly from the member or the member's employer.

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Where 75 percent or more of a group using club facilities are members, it will likewise be assumed for audit purposes that the nonmembers in the group are guests of members, provided payment for such use is received by the club directly from one or more of the members or the member's employer.

Rev. Proc. 71-17, Section 3.03.

In Pittsburgh Press Club v. United States, 615 F.2d 600 (3<sup>rd</sup> Cir. 1980), the Third Circuit upheld the Commissioner's determination that a social club failed to qualify for exemption from income tax as a §501(c)(7) organization because it was operated for business and not for the pleasure and recreation of its members. The Pittsburgh Press Club was organized for the purpose of providing a professional and social meeting place for its members. During the years under exam, however, the Pittsburgh Press Club hosted several functions for nonmember outside groups, although each such group had been member sponsored. Based on the amount of nonmember revenues (\$281,000 of nonmember receipts), as well as the percentage of those revenues (11 to 17 percent of gross receipts), the Third Circuit upheld the revocation stating that the exemption from Federal income tax for §501(c)(7) organizations "is to be strictly construed." Pittsburgh Press Club, 615 F.2d at 606. The Court stated that such strict construction cannot be reconciled with the fact that a substantial amount of the Club's activities and income consisted of nonmember functions and nonmember income. Therefore, the Court held "revocation of its exemption was proper." Id.

### **Recordkeeping and Reporting Requirements**

Every person liable for any tax imposed by the Code, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time prescribe. See I.R.C. § 6001. Every organization exempt from tax under I.R.C. § 501(a), and subject to the tax imposed by I.R.C. § 511 on its unrelated business income, must keep such permanent books or accounts or records, including inventories, as are sufficient to establish the amount of gross income, deduction, credits, or other matters required to be shown by such person in any return of such tax. Such organization shall also keep such books and records as are required to substantiate the information required by §6033. See Treas. Reg. §§ 1.6001-1(a) and 1.6001-1(c). The books or records required by section 1.6001-1 shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law. See Treas. Reg. §1.6001-1(e). Except as provided, every organization exempt from tax under I.R.C. § 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. See I.R.C. § 6033(a)(1).

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Every organization which is exempt from tax, whether or not it is required to file an annual information return, shall submit such additional information as may be required by the Service for the purpose of inquiring into its exempt status and administering the provisions of subchapter F (i.e., I.R.C. § 501 and following), chapter 1 of subtitle A of the Code, I.R.C. § 6033, and chapter 42 of subtitle D of the Code. See Treas. Reg. §1.6033-2(i)(2). See also, I.R.C. § 6001, Treas. Reg. §1.6001-1.

An organization's failure or inability to file required information returns or otherwise to comply with the provisions of I.R.C. § 6033 and the regulations which implement it, may result in the termination of the organization's exempt status based on the grounds that the organization has not established that it is observing the conditions that are required for the continuation of its exempt status. See Rev. Rul. 59-95. These conditions require the filing of a complete and accurate annual information return (and other required federal tax forms) and the retention of records sufficient to determine whether the organization is operated for the purposes for which it was granted tax-exempt status and to determine its liability for any unrelated business income tax. *Id.*

Rev. Rul. 59-95, 1959-1 C.B. 627, concerns an exempt organization that was requested to produce a financial statement and statement of its operations for a certain year. Its records were so incomplete, however, that the organization was unable to furnish such statements. The Internal Revenue Service held that the organization's failure or inability to file the required information return or otherwise to comply with the provision of section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of its exempt status.

### **Unrelated Business Income Tax**

Section 511(a) of the Code imposes a tax upon the unrelated business taxable income of organizations exempt from federal income tax.

Section 512(a)(1) defines unrelated business taxable income as the gross income from any unrelated trade or business regularly carried on by the organization.

Section 513(a) defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income of funds or the use it makes of the profits derived) to the exercise or performance by such organization of its exempt functions.

Section 513(c) provides that the term "trade or business" includes any activity which is carried on for the

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production of income from the sale of goods. An activity does not lose its identity as trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may not be related to the exempt purposes of the organization.

Treas. Reg. § 1.513-1(d)(2) provides that a trade or business is related to exempt purposes only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income). It is substantially related, for purposes of section 513 of the Code, only if the causal relationship is a substantial one. For this relationship to exist, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends on each case upon the facts and circumstances involved.

In Rev. Rul. 68-46, 1968-1 C.B. 260 a war veterans' organization did not qualify for exemption from Federal income tax under I.R.C. § 501(c)(4) because it was primarily engaged in renting a commercial building and operating a public banquet and meeting hall having bar and dining facilities.

**Government's Position and Conclusions:**

**Issue 1.** ORG has established that it operates exclusively for the exempt purposes listed in Treas. Reg. § 1.501(c)(19)-1(c).

An organization described in Section 501(c)(19) of the Code carries out activities in furtherance of its exempt purposes only when such activities are carried out exclusively in furtherance of the purposes listed in Section 1.501(c)(19)-1(c) of the Regulations. Among these purposes is the provision of social and recreational activities for its members. Therefore, when a veterans organization described in Section 501(c)(19) provides social and recreational activities for its members, or for guests whose expenses are paid by members, it is engaged in activities in furtherance of its exempt purposes.

Where goods or services are furnished to nonmembers who provide payment for such goods or services, their furnishing is outside the scope of Section 1.501(c)(19)-1(c) of the Regulations. Generally, if an organization has not kept adequate books and records concerning its financial transactions with nonmembers and more than 50 percent of its gross receipts are derived from sales transactions (e.g. restaurant and bar sales), the presumption will be that the organization's exempt status should be revoked because it is not primarily engaged in Section 501(c)(19) activities. However, this presumption may be rebutted. All facts and circumstances must be reviewed to determine whether or not the organization is primarily engaged in Section 501(c)(19) activities.

An organization described in I.R.C. § 501(c)(19) carries out activities in furtherance of its exempt purposes only when such activities are carried out exclusively in furtherance of the purposes listed in Treas. Reg. § 1.501(c)(19)-1(c). Among these purposes is the provision of social and recreational

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activities for its members. In the instant case, documents were provided during the examination that demonstrated the exempt activities in which ORG engaged during the years at issue. ORG was able to provide records that demonstrated the amount of income for members, their families, guests, auxiliary members, and nonveterans. In reviewing the books and records for ORG, the income and the exempt activities vs. non-exempt activities demonstrated that ORG is primarily engaged in Section 501(c)(19) activities.

**Issue 2.** ORG has failed to satisfy the recordkeeping and reporting requirements provided by I.R.C. §§ 6001 and 6033.

The sections of the Internal Revenue Code and underlying regulations relating to the membership requirements for veterans organizations as recited above are explicit in their definition of the permissible member percentages a veteran's organization may enroll and still maintain its exempt status. In determining whether or not a veteran's organization meets the legal requirements for continued recognition of exemption from Federal income tax, the Service has virtually no latitude when membership infractions occur.

The legal requirements for recognition of exemption from Federal income tax for veterans' organizations are straight forward. Such organizations are subject to membership restrictions and must comply with these constraints in order to qualify for tax-exempt status. Moreover, if a veterans' organization such as a ORG wishes to maintain its tax-exempt status, it must continue to comply with the membership restrictions which initially qualified the Post for its tax-exempt status.

With respect to subsidiary organizations recognized as exempt under the umbrella of a group ruling, the Revenue Procedure cited above (Rev. Proc. 80-27, 1980-1 C.B. 677) makes it clear that all such subsidiary organizations must meet the legal requirements for recognition of exemption in order to be included in the group ruling. The fact of holding a Charter from the national organization carries no automatic provision for inclusion in the group to which the tax-exempt status applies. That is, the Income Tax Regulations which restrict the membership qualifications for veterans organizations seeking an individual ruling letter are equally applicable to all other similar veterans organizations seeking to be included as a subsidiary under a group ruling letter.

The factors leading to this conclusion are two-fold.

First, ORG was not in compliance with the membership requirements during its December 31, 20XX tax year. Of the organization's 26 members, only 12 were veterans. That means that only 46 % of the organization's members were veterans. This fails the test in the Code which states that there must be at least 75% veterans members for a post to qualify under Section 501(c)(19) of the Code.

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Second, ORG was not in compliance with the membership requirements during its December 31, 20XX tax year. Of the organization's 25 members, only 12 were veterans. That means that only 48 % of the organization's members were veterans. This fails the test in the Code which states that there must be at least 75% veterans members for a post to qualify under Section 501(c)(19) of the Code.

Therefore, since the organization does not pass the membership requirements for a veterans organization it does not qualify for exemption under Section 501(c)(19) of the Code.

With respect to the desire to make correction to its membership roster and retain tax-exempt status, the legal requirements set forth in IRC sections 501(a) or 501(c) do not provide for exceptions based on an organization's correction or remedy of the condition that caused its disqualification. In addition to the above, it appears that to permit such a correction would have the effect of relieving the ORG HQ of its responsibility of ensuring that all of its subordinate units included in the group ruling comply with the legal requirements for inclusion. There is no legal precedent to support such a decision, and no such action is recommended.

**Taxpayer's Position:**

ORG agrees with the position that it does not qualify for exemption under Section 501(c)(19) of the Code because the membership test is not met.

**Conclusion:**

1. Since the organization does not meet the membership requirements of a veterans organization, it does not qualify for exemption from federal income tax under Section 501(c)(19) of the Code.

Since the organization does not qualify for exemption from federal income tax under Section 501(c)(19) of the Code, it's exempt status is hereby revoked effective January 1, 20XX.

**Note:**

**Please note that this is not a final report. The draft report is subject to review and modification by our Mandatory Review Staff and subject to approval by Exempt Organization's management. You may receive a revised final report in the future.**